

## **Bank financing of Equities and Investments in Shares (Revised Guidelines)**

**May 11, 2001**

In pursuance of the announcement made in October, 2000 in the Mid-term Review of the Monetary and Credit Policy for the year 2000-2001, the RBI-SEBI Technical Committee had reviewed the RBI guidelines set out in circular dated November 10, 2000 on banks' investment in shares as also advances against shares and other connected exposures. Based on the feed back received from banks and market participants on the recommendations made by the Technical Committee and the draft amendments proposed to the earlier guidelines, Reserve Bank of India has issued today the revised guidelines on banks' investment in shares and financing of equities. The revised guidelines will come into effect from May 11, 2001.

Keeping in view the basic features as indicated in circular dated November 10, 2000, the following changes have been made in the revised guidelines in the light of recent developments :

(i) Ceiling on Overall Exposure to Capital Market :

The ceiling of 5% prescribed in the November 2000 guidelines on investments in capital market will continue but will also now apply to total exposure of a bank to stock markets (including loans / advances to individuals / corporates and stockbrokers for investment in shares / debentures etc.). It is clarified that the ceiling will not apply to shares / convertible debentures etc. assigned to the banks as collateral by individuals / corporates for availing of banks credit for carrying out normal trade / production / investment or other developmental activities (which do not involve stock-broking or investment in capital markets).

(ii) Avoidance of concentration to a few stockbroking entities :

Recognising the nexus that has been observed among a few participants in stock markets, it has been proposed that each bank should fix, within the overall ceiling of 5%, a sub-ceiling for total advances to-

- (a) all the stock brokers and market makers (both fund based and non fund based) and,
- (b) to individual stockbroking entities, its associate / interconnected companies

(iii) Advances to individuals :

The existing instructions in regard to advances to individuals and financing of IPOs remain unchanged (except in regard to margins).

(iv) Margins :

A measure of simplification and rationalization, of margins prescribed has been introduced. Thus, as against the existing stipulation regarding minimum cash margin of 25% for issue of guarantees, 25% margin for advances against demat shares and 50% for advances against physical shares, a uniform margin of 40% on all advances / guarantees with a minimum cash margin of 20% ( within the margin of 40% ) in respect of guarantees issued by banks has been proposed.

(v) Financing of arbitrage operations

Stray cases of questionable operations of banks' investments in secondary markets were also noticed warranting a clear enunciation of policy on arbitrage operations. Hence, the revised guidelines make the following stipulations :

(a) Banks should not undertake arbitrage operations themselves or extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchanges.

(b) While banks are permitted to acquire shares from the secondary market, they should ensure that no sale transaction is undertaken without actually holding the shares in its investment account.

(vi) Segregation of responsibilities relating to investment and surveillance functions :

As a further safeguard to prevent any nexus from emerging, the revised guidelines emphasise that there should be clear separation of decision making in regard to investments in shares / advances against shares, which will be done by the Investment Committee, to be set up by the Board. The surveillance and monitoring of investments / advances against shares have to be done by the separate and independent Audit Committee of the Board which will review the total exposure of the bank to capital market, both fund based and non fund based, in all forms. The Audit Committee should ensure that the guidelines issued by RBI, and the Board of the bank are complied with, and adequate risk management and internal control systems are in place.

(vii) Transitional provisions

The revised guidelines include certain "transitional provisions" in order to ensure smooth transition to the new rules and to provide sufficient time to banks to adjust their portfolio of investment in shares and advances / guarantees against shares.

The detailed guidelines are annexed and have also been placed on the RBI website.

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**Press Release : 2000-2001/1538**